

ACADIA PHARMACEUTICALS INC

Form 10-Q

August 10, 2011

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended June 30, 2011

or

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
Commission File Number: 000-50768

**ACADIA PHARMACEUTICALS INC.**

(Exact Name of Registrant as Specified in Its Charter)

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**Delaware**  
(State of Incorporation)

**06-1376651**  
(I.R.S. Employer

**3911 Sorrento Valley Boulevard**

Identification No.)

**San Diego, California**  
(Address of Principal Executive Offices)

**92121**  
(Zip Code)

**(858) 558-2871**

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Securities Exchange Act of 1934.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Total shares of common stock outstanding as of the close of business on July 31, 2011:

Class	Number of Shares Outstanding
Common Stock, \$0.0001 par value	52,799,606

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**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**ACADIA PHARMACEUTICALS INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except for par value and share data)

(Unaudited)

	June 30, 2011	December 31, 2010(1)
<b>Assets</b>		
Cash and cash equivalents	\$ 8,020	\$ 6,849
Investment securities, available-for-sale	32,341	30,238
Prepaid expenses, receivables and other current assets	654	762
Total current assets	41,015	37,849
Property and equipment, net	208	426
Other assets	86	119
Total assets	\$ 41,309	\$ 38,394
<b>Liabilities and Stockholders' Equity</b>		
Accounts payable	\$ 1,139	\$ 1,972
Accrued expenses	4,015	3,219
Current portion of deferred revenue	753	690
Current portion of long-term debt	40	78
Total current liabilities	5,947	5,959
Long-term portion of deferred revenue	2,481	2,623
Other long-term liabilities	60	124
Total liabilities	8,488	8,706
Commitments (Note 9)		
Stockholders' equity		
Preferred stock, \$0.0001 par value; 5,000,000 shares authorized at June 30, 2011 and December 31, 2010; no shares issued and outstanding at June 30, 2011 and December 31, 2010		
Common stock, \$0.0001 par value; 150,000,000 shares and 75,000,000 shares authorized at June 30, 2011 and December 31, 2010, respectively; 52,799,606 shares and 39,350,561 shares issued and outstanding at June 30, 2011 and December 31, 2010, respectively		
	5	4
Additional paid-in capital	369,301	353,278
Accumulated deficit	(336,495)	(324,106)
Accumulated other comprehensive income	10	512
Total stockholders' equity	32,821	29,688

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Total liabilities and stockholders' equity	\$ 41,309	\$ 38,394
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- (1) The condensed consolidated balance sheet at December 31, 2010 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

The accompanying notes are an integral part of these condensed consolidated financial statements.

**Table of Contents****ACADIA PHARMACEUTICALS INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
<b>Revenues</b>				
Collaborative revenues	\$ 460	\$ 2,297	\$ 895	\$ 4,430
<b>Operating expenses</b>				
Research and development (includes stock-based compensation of \$134, \$150, \$255, and \$379, respectively)	4,315	5,041	8,727	10,857
General and administrative (includes stock-based compensation of \$279, \$223, \$534, and \$475, respectively)	2,729	1,552	4,613	3,366
Total operating expenses	7,044	6,593	13,340	14,223
Loss from operations	(6,584)	(4,296)	(12,445)	(9,793)
Interest income, net	28	8	56	18
Net loss	\$ (6,556)	\$ (4,288)	\$ (12,389)	\$ (9,775)
Net loss per common share, basic and diluted	\$ (0.12)	\$ (0.11)	\$ (0.24)	\$ (0.25)
Weighted average common shares outstanding, basic and diluted	52,677	38,347	51,535	38,341

The accompanying notes are an integral part of these condensed consolidated financial statements.

**Table of Contents****ACADIA PHARMACEUTICALS INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)****(Unaudited)**

	<b>Six Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
<b>Cash flows from operating activities</b>		
Net loss	\$ (12,389)	\$ (9,775)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	225	312
Stock-based compensation	789	854
Non-cash charge resulting from lease termination	806	
Other	219	(244)
Changes in operating assets and liabilities:		
Prepaid expenses, receivables and other current assets	117	(2,657)
Other assets	35	(7)
Accounts payable	(851)	(633)
Accrued expenses	786	(1,208)
Deferred revenue	(79)	623
Other long-term liabilities	(45)	(50)
<b>Net cash used in operating activities</b>	<b>(10,387)</b>	<b>(12,785)</b>
<b>Cash flows from investing activities</b>		
Purchases of investment securities	(33,156)	(25,057)
Maturities of investment securities	30,843	28,687
Proceeds from sales of property and equipment		128
<b>Net cash provided by (used in) investing activities</b>	<b>(2,313)</b>	<b>3,758</b>
<b>Cash flows from financing activities</b>		
Proceeds from issuance of common stock	13,914	44
Repayments of long-term debt	(57)	(251)
<b>Net cash provided by (used in) financing activities</b>	<b>13,857</b>	<b>(207)</b>
Effect of exchange rate changes on cash	14	(77)
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>1,171</b>	<b>(9,311)</b>
<b>Cash and cash equivalents</b>		
Beginning of period	6,849	18,122
End of period	\$ 8,020	\$ 8,811

The accompanying notes are an integral part of these condensed consolidated financial statements.





**Table of Contents****ACADIA PHARMACEUTICALS INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****June 30, 2011****(Unaudited)****1. Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements of ACADIA Pharmaceuticals Inc. (together with its wholly owned subsidiaries, the Company) should be read in conjunction with the audited financial statements and notes thereto as of and for the year ended December 31, 2010 included in the Company's Annual Report on Form 10-K (Annual Report) filed with the Securities and Exchange Commission (the SEC). The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, since they are interim statements, the accompanying financial statements do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, the accompanying financial statements reflect all adjustments (consisting of normal recurring adjustments) that are necessary for a fair statement of the financial position, results of operations and cash flows for the interim periods presented. Interim results are not necessarily indicative of results for a full year. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

The Company has incurred substantial operating losses since its inception due in large part to expenditures for its research and development activities. As of June 30, 2011, the Company had an accumulated deficit of \$336.5 million. The Company expects to continue to incur operating losses for at least the next several years as it pursues the development of its product candidates.

The Company will require significant additional financing in the future to fund its operations. Future capital requirements will depend on many factors, including the progress in, the outcome of and the costs of the Company's clinical trials, the scope, prioritization and number of its research and development programs, and the ability of its collaborators and the Company to reach the milestones, and other events or developments under its collaboration and license agreements. Until the Company can generate significant continuing revenues, it expects to fund its operations through its existing cash, cash equivalents and investment securities, payments from existing and potential future collaborations, proceeds from private or public sales of its securities, debt financing, grant funding, or by licensing all or a portion of its product candidates or technology. The Company cannot be certain that additional funding will be available on acceptable terms, or at all. Conditions in the financial markets and other factors could have a material adverse effect on the Company's ability to access sufficient funding on acceptable terms, or at all. If the Company cannot raise adequate additional capital, it will be required to delay, further reduce the scope of, or eliminate one or more of its research or development programs or its commercialization efforts. In addition, the Company may be required to relinquish greater, or even all, rights to product candidates at earlier stages of development or on less favorable terms than it would otherwise choose.

**2. Earnings (Loss) Per Share**

Basic earnings (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares outstanding for the period. Diluted earnings (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period increased to include potential dilutive common shares that were outstanding during the period. The effect of outstanding stock options and warrants, when dilutive, is reflected in diluted earnings (loss) per common share by application of the treasury stock method. The Company has excluded all outstanding stock options and warrants from the calculation of diluted net loss per common share because all such securities are antidilutive for all periods presented.

Shares used in calculating basic and diluted net loss per common share exclude these potential common shares (in thousands):

<b>Three Months Ended</b>	<b>Six Months Ended</b>
<b>June 30,</b>	<b>June 30,</b>
<b>2011</b>	<b>2011</b>
<b>2010</b>	<b>2010</b>
<b>(unaudited)</b>	<b>(unaudited)</b>

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Antidilutive options to purchase common stock	5,593	4,466	5,172	4,065
Antidilutive warrants to purchase common stock	4,692	954	4,423	1,174
	10,285	5,420	9,595	5,239

### 3. Stock-Based Compensation

The fair value of each stock option and each employee stock purchase plan right granted is estimated on the grant date under the fair value method using the Black-Scholes valuation model. The estimated fair values of the stock option or purchase plan rights,

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including the effect of estimated forfeitures, are then expensed over the vesting period. The Company recognized stock-based compensation expense of \$413,000 and \$789,000 during the three and six months ended June 30, 2011, respectively, and \$373,000 and \$854,000 during the three and six months ended June 30, 2010, respectively. At June 30, 2011, total unrecognized compensation cost related to stock options and purchase plan rights was \$2.7 million, which is expected to be recognized over a weighted-average period of 2.6 years.

**4. Comprehensive Loss**

Comprehensive loss consisted of the following (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011 (unaudited)	2010 (unaudited)	2011 (unaudited)	2010 (unaudited)
Net loss	\$ (6,556)	\$ (4,288)	\$ (12,389)	\$ (9,775)
Unrealized gain (loss) on investment securities	(3)	8	10	6
Foreign currency translation adjustments	(524)	(76)	(512)	(88)
Total comprehensive loss	\$ (7,083)	\$ (4,356)	\$ (12,891)	\$ (9,857)

**5. Accrued Expenses**

Accrued expenses consisted of the following (in thousands):

	June 30, 2011	December 31, 2010 (unaudited)
Accrued clinical development services	\$ 3,030	\$ 2,339
Accrued compensation and benefits	522	537
Other	463	343
Total	\$ 4,015	\$ 3,219

**6. Fair Value Measurements**

As of June 30, 2011, the Company held \$39.8 million of cash equivalents and available-for-sale investment securities consisting of a money market fund, U.S. Treasury notes, and high quality, marketable debt instruments of corporations, financial institutions and government sponsored enterprises. The Company has adopted an investment policy and established guidelines relating to credit quality, diversification and maturities of its investments to preserve principal and maintain liquidity. All investment securities have a credit rating of at least AA or A1+/p1 as determined by Moody's Investors Service and/or Standard & Poor's.

The Company's cash equivalents and available-for-sale investment securities are classified within the fair value hierarchy as defined by authoritative guidance. The Company's investment securities classified as Level 1 are valued using quoted market prices and the Company's investment securities classified as Level 2 are valued using other observable inputs such as recent trades for the securities or similar securities, interest rates on similar securities, or yield curves or benchmark interest rates observable at commonly quoted intervals. The Company does not hold any securities classified as Level 3, which are securities valued using unobservable inputs. The Company has not transferred assets between the fair value measurement classifications. No other-than-temporary impairments were identified for the investment securities held by the Company as of June 30, 2011.

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The fair value measurements of the Company's cash equivalents and available-for-sale investment securities are identified in the following hierarchy (in thousands):

	Fair Value Measurements at Reporting Date Using			
	June 30, 2011	Quoted Prices		
		in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market fund	\$ 7,501	\$ 7,501	\$	\$
U.S. Treasury notes	3,303	3,303		
Government sponsored enterprise securities	12,629		12,629	
Corporate debt securities	16,409		16,409	
	\$ 39,842	\$ 10,804	\$ 29,038	\$

	Fair Value Measurements at Reporting Date Using			
	December 31, 2010	Quoted Prices		
		in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market fund	\$ 6,403	\$ 6,403	\$	\$
U.S. Treasury notes	4,291	4,291		
Government sponsored enterprise securities	23,428		23,428	
Corporate debt securities	2,519		2,519	
	\$ 36,641	\$ 10,694	\$ 25,947	\$

**7. Collaboration and License Agreements**

The Company is currently a party to three separate collaboration agreements with Allergan, Inc. Pursuant to the March 2003 collaboration agreement, the Company had received an aggregate of \$18.0 million in payments as of June 30, 2011, consisting of an upfront payment, research funding and related fees. This collaboration originally provided for a three-year research term, which has been extended by the parties through March 2012. The Company's two other collaboration agreements with Allergan involve the development of product candidates in the areas of chronic pain and glaucoma. The Company is eligible to receive payments upon achievement of development and regulatory milestones, as well as royalties on product sales, if any, under each of the three collaboration agreements with Allergan. The Company recognized revenues from its collaboration agreements with Allergan of \$271,000 and \$535,000 during the three and six months ended June 30, 2011, respectively, and \$263,000 and \$534,000 during the three and six months ended June 30, 2010, respectively.

In March 2009, the Company entered into a collaboration agreement with Meiji Seika Pharma Co., Ltd. (Meiji Seika Pharma). Under the agreement, the Company is eligible to receive up to \$25 million in aggregate payments, including \$3 million in license fees and up to \$22 million in potential development and regulatory milestone payments, in addition to royalties on product sales, if any, in the licensed Asian territory. Meiji Seika Pharma also is responsible for the first \$15 million of designated development expenses, of which approximately \$1.5

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million had been incurred through June 30, 2011. The Company recognized revenues relating to this collaboration of \$99,000 and \$194,000 during the three and six months ended June 30, 2011, respectively, and \$83,000 and \$237,000 during the three and six months ended June 30, 2010, respectively. At June 30, 2011, \$2.8 million of revenue was deferred under this agreement, of which \$368,000 was included in current liabilities and \$2.5 million was included in long-term liabilities. At December 31, 2010, \$3.0 million of revenue was deferred under this agreement, of which \$362,000 was included in current liabilities and \$2.6 million was included in long-term liabilities.

In May 2009, the Company entered into a collaboration agreement with Biovail Laboratories International SRL ( Biovail ), a subsidiary of Biovail Corporation, pursuant to which the Company received a non-refundable \$30 million upfront payment. Under this collaboration, the Company also was eligible to receive potential development, regulatory and sales milestones as well as royalties on future net sales of pimavanserin. In October 2010, the Company and Biovail entered into an agreement pursuant to which the

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Company reacquired all rights to pimavanserin and the parties concluded their collaboration. In connection with this agreement, the Company recorded all remaining revenues related to its collaboration with Biovail, which totaled \$34.7 million, during the fourth quarter of 2010. The Company has no future obligations to Biovail. The Company recognized revenues relating to this collaboration of \$1.8 million and \$3.2 million during the three and six months ended June 30, 2010, respectively.

### **8. Private Equity Financing**

In January 2011, the Company raised net proceeds of approximately \$13.8 million through the sale of 12,565,446 units at a price of \$1.19375 per unit to a group of institutional investors in a private equity financing. Each unit consisted of one share of the Company's common stock and a warrant to purchase 0.35 shares of common stock. The warrants have an exercise price of \$1.38 per share, became exercisable on July 12, 2011, and will expire on January 11, 2018. In accordance with authoritative accounting guidance, the allocated fair value of the warrants at the issuance date of \$3.3 million was recorded as permanent equity during the three months ended March 31, 2011. The fair value of the warrants was determined using the Black-Scholes model. Pursuant to the terms of the private placement, the Company has an effective resale registration statement on file with the SEC covering the shares of common stock sold in the private placement and the shares of common stock issuable upon the exercise of the warrants.

### **9. Commitments**

In April 2011, the Company entered into a termination agreement related to its Swedish research facility and ceased operations at this site. Pursuant to the agreement, the Company made a one-time payment of \$690,000 and issued 782,339 shares of its common stock to the landlord in settlement of all lease-related obligations. General and administrative expenses for the three and six months ended June 30, 2011 included a net charge of \$1.1 million, which amount consisted of \$1.7 million in lease termination charges offset by a \$539,000 reduction in the Company's cumulative translation adjustment balance related to the liquidation of substantially all assets of its Swedish subsidiary.

The Company has entered into agreements with contract research organizations and other external service providers for services in connection with the development of its product candidates. The Company was contractually obligated for up to approximately \$9.0 million of future services under these agreements as of June 30, 2011. The nature of the work being conducted under the Company's agreements with contract research organizations is such that, in most cases, the services may be stopped with short notice. In such event, the Company would generally not be liable for the full amount of the contract. The Company's actual contractual obligations will vary depending upon several factors, including the progress and results of the underlying services.

### **10. Recent Accounting Pronouncements**

In May 2011, the Financial Accounting Standards Board (FASB) issued accounting guidance related to fair value measurements and disclosures to achieve common fair value measurements and disclosures between GAAP and International Financial Reporting Standards. This guidance clarifies the application of certain existing fair value measurement guidance and expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. This guidance is effective on a prospective basis for annual and interim reporting periods beginning on or after December 15, 2011. The Company does not believe the adoption of this guidance will have a material impact on its consolidated financial statements.

In June 2011, the FASB issued authoritative guidance which amends existing guidance related to the presentation of comprehensive income. This guidance (1) eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity; (2) requires the consecutive presentation of the statement of net income and other comprehensive income; and (3) requires an entity to present reclassification adjustments on the face of the financial statements from other comprehensive income to net income. This guidance does not change the items that must be reported in other comprehensive income, when an item of other comprehensive income must be reclassified to net income, or affect how earnings per share is calculated or presented. This guidance is effective for interim reporting periods and fiscal years beginning after December 15, 2011 and will be applied on a retrospective basis for all periods presented. The Company believes this guidance will result in enhanced disclosure of its financial statements.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis of our consolidated financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and related notes included in this quarterly report on Form 10-Q, or this Quarterly Report, and the audited financial statements and notes thereto as of and for the year ended December 31, 2010 included with our Annual Report filed with the SEC. Past operating results are not necessarily indicative of results that may occur in future periods.

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This Quarterly Report contains forward-looking statements. These forward-looking statements involve a number of risks and uncertainties. Such forward-looking statements include statements about our strategies, objectives, expectations, discoveries, collaborations, clinical trials, product candidates, proprietary and external programs, and other statements that are not historical facts, including statements which may be preceded by the words believes, expects, hopes, may, will, plans, intends, estimates, could, should, would, continue, seeks, aims, anticipates, potential or

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similar words. For such statements, we claim the protection of the Private Securities Litigation Reform Act of 1995. Readers of this Quarterly Report are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date on which they are made. We undertake no obligation to update publicly or revise any forward-looking statements. Actual events or results may differ materially from our expectations. Important factors that could cause actual results to differ materially from those stated or implied by our forward-looking statements include, but are not limited to, the risk factors identified in our filings with the SEC, including this Quarterly Report.

### **Overview**

#### ***Background***

We are a biopharmaceutical company focused on the development and commercialization of small molecule drugs for the treatment of central nervous system disorders. Our pipeline consists of four product candidates including pimavanserin, which is in Phase III development as a potential first-in-class treatment for Parkinson's disease psychosis. We hold worldwide commercialization rights to pimavanserin. In addition, we have a product candidate in Phase II development for chronic pain and a product candidate in Phase I development for glaucoma, both in collaboration with Allergan, as well as a program in IND-track development in collaboration with Meiji Seika Pharma. All of the product candidates in our pipeline emanate from discoveries made using our proprietary drug discovery platform.

We have incurred substantial operating losses since our inception due in large part to expenditures for our research and development activities. As of June 30, 2011, we had an accumulated deficit of \$336.5 million. We expect to continue to incur operating losses for at least the next several years as we pursue the clinical development of our product candidates.

We maintain a website at [www.acadia-pharm.com](http://www.acadia-pharm.com) to which we regularly post copies of our press releases as well as additional information about us. Our filings with the SEC are available free of charge through our website as soon as reasonably practicable after being electronically filed with or furnished to the SEC. Interested persons can subscribe on our website to email alerts that are sent automatically when we issue press releases, file our reports with the SEC or post certain other information to our website. Information contained in our website does not constitute a part of this Quarterly Report.

#### ***Recent Developments***

In May 2011, we were awarded a grant from the National Institute of Neurological Disorders and Stroke, or NINDS, a division of the National Institutes of Health, for the development of novel ER-beta agonists for the treatment of neuropathic pain. The grant provides funding of up to \$2.4 million over several years and was awarded under the NINDS Fast-Track Small Business Innovative Research Cooperative Program in Translational Research that supports the identification and preclinical testing of new therapeutics for neurological disorders.

In April 2011, in order to reduce our facilities expenses, we entered into a termination agreement related to our Swedish research facility and ceased operations at this site. Pursuant to the agreement, we made a one-time payment of \$690,000 and issued 782,339 shares of our common stock to the landlord in settlement of all lease-related obligations. General and administrative expenses for the three and six months ended June 30, 2011 included a net charge of \$1.1 million resulting from the termination of our Swedish facility lease. Following this lease termination, we expect to save approximately \$1.5 million in facilities and related expenses on an annual basis.

#### ***Revenues***

We have not generated any revenues from product sales to date, and we do not expect to generate revenues from product sales for at least the next several years, if at all. Our revenues to date have been generated substantially from payments under our current and past collaboration agreements. As of June 30, 2011, we had received an aggregate of \$111.6 million in payments under these agreements, including upfront payments, research funding, and milestone payments. We expect our revenues for the next several years to consist primarily of revenues derived from payments under our current agreements with Allergan and Meiji Seika Pharma and potential additional collaborations as well as grant funding.

We currently are a party to three separate collaboration agreements with Allergan. Pursuant to our March 2003 collaboration agreement with Allergan, we had received an aggregate of \$18.0 million in payments as of June 30, 2011, consisting of an upfront payment, research funding and related fees. This collaboration agreement originally provided for a three-year research term, which has been extended by the parties through March 2012. Our two other collaboration agreements with Allergan involve the development of product candidates in the areas of chronic pain and glaucoma. We are eligible to receive payments upon achievement of development and regulatory milestones, as well as royalties on product sales, if any, under each of our three collaboration agreements with Allergan. Each of our agreements with Allergan is subject to early termination upon specified events, including, in the case of one of our agreements, if we have a change in control. Upon the conclusion of the



research term under each agreement, Allergan may terminate the agreement by notice.

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In March 2009, we entered into a collaboration agreement with Meiji Seika Pharma. Under the agreement, we are eligible to receive up to \$25 million in aggregate payments, including \$3 million in license fees and up to \$22 million in potential development and regulatory milestones, as well as royalties on product sales, if any, in the licensed Asian territory. As of June 30, 2011, we had received an aggregate of \$4.1 million in payments from Meiji Seika Pharma, consisting of license fees and reimbursed research and development expenses. Meiji Seika Pharma is responsible for the first \$15 million of designated development expenses and we will share the remaining expenses through clinical proof-of-concept, subject to possible adjustment in the event we further license the program outside of the Asian territory. Our agreement with Meiji Seika Pharma is subject to early termination upon specified events.

In May 2009, we entered into a collaboration agreement with Biovail, pursuant to which we received a non-refundable \$30 million upfront payment. Under this collaboration, we also were eligible to receive potential development, regulatory and sales milestones as well as royalties on future net sales of pimavanserin. In October 2010, we entered an agreement with Biovail to regain all rights to pimavanserin and conclude our collaboration. In connection with this agreement, we recorded all remaining revenues related to our collaboration with Biovail during the fourth quarter of 2010. We have no future obligations to Biovail.

**Research and Development Expenses**

Our research and development expenses consist primarily of fees paid to external service providers, salaries and related personnel expenses, facilities and equipment expenses, and other costs. We charge all research and development expenses to operations as incurred. Our research and development activities are primarily focused on our most advanced product candidates, including pimavanserin. We currently are responsible for all future costs incurred in the development of pimavanserin as well as for the costs associated with our other internal programs.

Pursuant to our collaboration, Meiji Seika Pharma is responsible for the first \$15 million of designated development expenses for the product candidate, AM-831, and we and Meiji Seika Pharma will share remaining expenses through clinical proof-of-concept, subject to possible adjustment. As of June 30, 2011, approximately \$1.5 million of the designated development expenses had been incurred. We expect to coordinate a significant portion of the planned external development services and, accordingly, we may incur the related development costs for these external services and receive reimbursement of Meiji Seika Pharma's portion of these costs pursuant to the agreement. Meiji Seika Pharma is responsible for all costs associated with the development of AM-831 in the Asian territory. We are not responsible for, nor have we incurred, development expenses in our clinical programs for chronic pain and glaucoma, which we are pursuing in collaboration with Allergan.

We use external service providers to manufacture our product candidates to be used in clinical trials and for the majority of the services performed in connection with the preclinical and clinical development of our product candidates. We have used our internal research and development resources, including our employees and discovery infrastructure, across several projects and many of our costs have not been attributable to a specific project but were directed to broadly applicable research activities. Accordingly, we have not reported our internal research and development costs on a project basis. To the extent that external expenses are not attributable to a specific project, they are included in other external costs. The following table summarizes our development expenses for the three and six months ended June 30, 2011 and 2010 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011 (unaudited)	2010	2011 (unaudited)	2010 (unaudited)
External costs:				
Pimavanserin	\$ 2,751	\$ 3,164	\$ 5,116	\$ 6,803
AM-831 and other	319	247	571	416
Subtotal	3,070	3,411	5,687	7,219
Internal costs	1,111	1,480	2,785	3,259
Stock-based compensation	134	150	255	379
<b>Total research and development</b>	<b>\$ 4,315</b>	<b>\$ 5,041</b>	<b>\$ 8,727</b>	<b>\$ 10,857</b>

At this time, due to the risks inherent in the clinical trial process and given the stage of development of our programs, we are unable to estimate with any certainty the costs we will incur for the continued development of our product candidates for potential commercialization. Due to these same factors, we are unable to determine the anticipated completion dates for our current research and development programs. Clinical

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development timelines, probability of success, and development costs vary widely. While our current focus is primarily on advancing the clinical development of pimavanserin, we anticipate that we will make determinations as to which programs to pursue and how much funding to direct to each program on an ongoing basis in response to the scientific and clinical success of each product candidate, as well as an ongoing assessment of each product candidate's commercial potential and our financial position. We cannot forecast with any degree of certainty which product candidates will be subject to future collaborative or licensing arrangements, when such arrangements will be secured, if at all, and to what degree such arrangements would affect our development plans and capital requirements.

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We expect our external research and development expenses to continue to be substantial as we pursue the development of pimavanserin and our other product candidates. The lengthy process of completing clinical trials and seeking regulatory approval for our product candidates requires the expenditure of substantial resources. Any failure by us or delay in completing clinical trials, or in obtaining regulatory approvals could cause our research and development expenses to increase and, in turn, have a material adverse effect on our results of operations.

### ***General and Administrative Expenses***

Our general and administrative expenses have consisted primarily of salaries and other costs for employees serving in executive, finance, business development, and business operations functions, as well as professional fees associated with legal and accounting services, and costs associated with patents and patent applications for our intellectual property.

### **Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements. We have identified the accounting policies that we believe require application of management's most subjective judgments, often requiring the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. Our actual results may differ substantially from these estimates under different assumptions or conditions.

### ***Revenue Recognition***

We recognize revenues in accordance with authoritative guidance established by GAAP. Our revenues are primarily related to our collaboration agreements, which may provide for various types of payments to us, including upfront payments, funding of research and development, milestone payments, and licensing fees. Our collaboration agreements also include potential payments for product royalties; however, we have not received any product royalties to date.

We consider a variety of factors in determining the appropriate method of accounting under our collaboration agreements, including whether the various elements can be separated and accounted for individually as separate units of accounting. Where there are multiple deliverables identified within a collaboration agreement that are combined into a single unit of accounting, revenues are deferred and recognized over the expected period of performance. The specific methodology for the recognition of the revenue is determined on a case-by-case basis according to the facts and circumstances of the applicable agreement.

Upfront, non-refundable payments that do not have stand-alone value are recorded as deferred revenue once received and recognized as revenues over the expected period of performance. Revenues from non-refundable license fees are recognized upon receipt of the payment if the license has stand-alone value, we do not have ongoing involvement or obligations, and we can determine the best estimate of the selling price for any undelivered items. When non-refundable license fees do not meet all of these criteria, the license revenues are recognized over the expected period of performance. Non-refundable payments for research funding are generally recognized as revenues over the period as the related research activities are performed. Payments for reimbursement of external development costs are generally recognized as revenues using a contingency-adjusted performance model over the expected period of performance based on the nature of the related agreement. Payments received from grants are recognized as revenue as the related research and development is performed and when collectability has been reasonably assured.

We evaluate milestone payments on an individual basis and recognize revenues from non-refundable milestone payments when the earnings process is complete and the payment is reasonably assured. Non-refundable milestone payments related to arrangements under which we have continuing performance obligations are recognized as revenue upon achievement of the associated milestone, provided that (i) the milestone event is substantive and its achievability was not reasonably assured at the inception of the agreement and (ii) the amount of the milestone payment is reasonable in relation to the effort expended or the risk associated with the milestone event. Where separate milestone payments do not meet these criteria, we recognize revenue using a contingency-adjusted performance model over the period of performance.

### ***Accrued Expenses***

We are required to estimate accrued expenses as part of our process of preparing financial statements. Examples of areas in which subjective judgments may be required include costs associated with services provided by contract organizations for preclinical development, manufacturing of clinical materials, and clinical trials. We accrue for costs incurred as the services are being provided by monitoring the status of the trials or services provided, and the invoices received from our external service providers. In the case of clinical trials, a portion of the cost normally relates to the projected cost to treat a patient in our trials and we recognize this cost over the term of the study based on the number of patients enrolled in the trial on an ongoing basis. As actual costs become known to us, we adjust our accruals. To date, our estimates have not differed

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significantly from the actual costs incurred. However, subsequent changes in estimates may result in a material change in our accruals, which could also materially affect our balance sheet and results of operations.

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**Table of Contents*****Stock-Based Compensation***

The fair value of each employee stock option and each employee stock purchase plan right granted is estimated on the grant date under the fair value method using the Black-Scholes model, which requires us to make a number of assumptions including the estimated expected life of the award and related volatility. The estimated fair values of stock options or purchase plan rights, including the effect of estimated forfeitures, are then expensed over the vesting period. As of June 30, 2011, total unrecognized compensation cost related to stock options and purchase plan rights was approximately \$2.7 million, and the weighted average period over which this cost is expected to be recognized is 2.6 years.

**Results of Operations*****Fluctuations in Operating Results***

Our results of operations have fluctuated significantly from period to period in the past and are likely to continue to do so in the future. We anticipate that our quarterly and annual results of operations will be impacted for the foreseeable future by several factors, including the timing and amount of payments received pursuant to our current and potential future collaborations and the progress and timing of expenditures related to our development efforts. Due to these fluctuations, we believe that the period-to-period comparisons of our operating results are not a good indication of our future performance.

***Comparison of the Three Months Ended June 30, 2011 and 2010******Revenues***

Revenues decreased to \$460,000 for the three months ended June 30, 2011 from \$2.3 million for the three months ended June 30, 2010. This decrease was primarily due to the conclusion of our collaboration with Biovail in October 2010, at which time we recognized all remaining revenues related to this collaboration. We recognized \$1.8 million in revenues from this collaboration during the three months ended June 30, 2010. Revenues from our collaborations with Allergan totaled \$271,000 for the three months ended June 30, 2011 and were comparable to the revenues from these collaborations for the three months ended June 30, 2010. Revenues from our agreements with other parties, including our collaboration with Meiji Seika Pharma, totaled \$189,000 for the three months ended June 30, 2011 compared to \$218,000 for the three months ended June 30, 2010.

***Research and Development Expenses***

Research and development expenses decreased to \$4.3 million for the three months ended June 30, 2011, including \$134,000 in stock-based compensation, from \$5.0 million for the three months ended June 30, 2010, including \$150,000 in stock-based compensation. The decrease in research and development expenses was primarily due to \$384,000 in decreased facility and other costs associated with our internal research and development organization and \$342,000 in decreased external service costs. External service costs totaled \$3.1 million, or 71 percent of our research and development expenses, for the three months ended June 30, 2011, compared to \$3.4 million, or 68 percent of our research and development expenses, for the comparable period in 2010. The decrease in external expenses was largely attributable to decreased costs incurred on our Phase III program for pimavanserin.

***General and Administrative Expenses***

General and administrative expenses increased to \$2.7 million for the three months ended June 30, 2011, including \$279,000 in stock-based compensation, from \$1.6 million for the three months ended June 30, 2010, including \$223,000 in stock-based compensation. The increase in general and administrative expenses was primarily attributable to a net charge of \$1.1 million resulting from the termination of our Swedish facility lease.

***Comparison of the Six Months Ended June 30, 2011 and 2010******Revenues***

Revenues decreased to \$895,000 for the six months ended June 30, 2011 from \$4.4 million for the six months ended June 30, 2010. This decrease was primarily due to the conclusion of our collaboration with Biovail in October 2010, at which time we recognized all remaining revenues related to this collaboration. We recognized \$3.2 million in revenues from this collaboration during the six months ended June 30, 2010. Revenues from our collaborations with Allergan totaled \$535,000 for the six months ended June 30, 2011 and were comparable to the

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revenues from these collaborations for the six months ended June 30, 2010. Revenues from our agreements with other parties, including our collaboration with Meiji Seika Pharma, totaled \$360,000 for the six months ended June 30, 2011 compared to \$668,000 for the six months ended June 30, 2010.

### *Research and Development Expenses*

Research and development expenses decreased to \$8.7 million for the six months ended June 30, 2011, including \$255,000 in stock-based compensation, from \$10.9 million for the six months ended June 30, 2010, including \$379,000 in stock-based compensation. The decrease in research and development expenses was primarily due to \$1.5 million in decreased external service

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costs and \$598,000 in decreased facility and personnel costs associated with our internal research and development organization. External service costs totaled \$5.7 million, or 65 percent of our research and development expenses, for the six months ended June 30, 2011, compared to \$7.2 million, or 66 percent of our research and development expenses, for the comparable period in 2010. The decrease in external service costs was largely attributable to decreased costs incurred on our Phase III program for pimavanserin.

### *General and Administrative Expenses*

General and administrative expenses increased to \$4.6 million for the six months ended June 30, 2011, including \$534,000 in stock-based compensation, from \$3.4 million for the six months ended June 30, 2010, including \$475,000 in stock-based compensation. The increase in general and administrative expenses was primarily attributable to a net charge of \$1.1 million resulting from the termination of our Swedish facility lease.

### **Liquidity and Capital Resources**

Since inception, we have funded our operations primarily through sales of our equity securities, payments received under our collaboration agreements, debt financings, and interest income. As of June 30, 2011, we had received \$341.5 million in net proceeds from sales of our equity securities, including \$6.9 million in debt we had retired through the issuance of our common stock, \$111.6 million in payments from collaboration agreements, \$22.4 million in debt financing, and \$22.1 million in interest income.

At June 30, 2011, we had \$40.4 million in cash, cash equivalents and investment securities compared to \$37.1 million at December 31, 2010. We currently expect that our cash, cash equivalents, investment securities and anticipated payments from our collaborations will be sufficient to fund our operations at least into the first half of 2013.

We will require significant additional financing in the future to fund our operations. Our future capital requirements will depend on, and could increase significantly as a result of, many factors, including:

progress in, and the costs of, our clinical trials, preclinical studies and other research and development programs;

the scope, prioritization and number of research and development programs;

the ability of our collaborators and us to reach the milestones, or other events or developments, under our collaboration agreements;

the extent to which we are obligated to reimburse our collaborators or our collaborators are obligated to reimburse us for clinical trial costs under our collaboration agreements;

the costs involved in filing, prosecuting, enforcing and defending patent claims and other intellectual property rights;

the costs of securing manufacturing arrangements for clinical or commercial production of product candidates; and

the costs of establishing, or contracting for, sales and marketing capabilities if we obtain regulatory clearances to market our product candidates.

Until we can generate significant continuing revenues, we expect to satisfy our future cash needs through strategic collaborations, private or public sales of our securities, debt financings, grant funding, or by licensing all or a portion of our product candidates or technology. We cannot be certain that additional funding will be available to us on acceptable terms, or at all. Over the last few years, turmoil and volatility in the financial markets have adversely affected the market capitalizations of many biotechnology companies and generally made equity and debt financing more difficult to obtain. This, coupled with other factors, may limit access to additional financing over the near-term future. In



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particular, given the disappointing results from an initial Phase III Parkinson's disease psychosis trial with pimavanserin that we announced in September 2009, any unfavorable outcome in our development of pimavanserin could have a material adverse effect on our ability to raise additional capital.

If we cannot raise adequate additional capital in the future, we will be required to delay, further reduce the scope of, or eliminate one or more of our research or development programs or our commercialization efforts. We also may be required to relinquish greater or all rights to product candidates at an earlier stage of development or on less favorable terms than we would otherwise choose.

We have invested a substantial portion of our available cash in a money market fund, U.S. Treasury notes, and high quality, marketable debt instruments of corporations, financial institutions and government sponsored enterprises. We have adopted an investment policy and established guidelines relating to credit quality, diversification and maturities of our investments to preserve principal and maintain liquidity. All investment securities have a credit rating of at least AA or A1+/p1 as determined by Moody's Investors Service and/or Standard & Poor's. Our investment portfolio has not been adversely impacted by the disruption in the credit markets that has occurred during the last few years. However, if there is further and expanded disruption in the credit markets, there can be no assurance that our investment portfolio will not be adversely affected in the future.

Net cash used in operating activities decreased to \$10.4 million for the six months ended June 30, 2011 from \$12.8 million for the six months ended June 30, 2010. This decrease was primarily due to changes in operating assets and liabilities, including changes

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in prepaid expenses, receivables and other current assets, accounts payable and accrued expenses, and a non-cash charge resulting from termination of our Swedish facility lease incurred during the six months ended June 30, 2011, offset by an increase in our net loss. During the six months ended June 30, 2011, prepaid expenses, receivables and other current assets decreased by \$117,000 compared to an increase of \$2.7 million for the comparable period of 2010. The increase in prepaid expenses, receivables and other current assets during the six months ended June 30, 2010 was primarily attributable to a collaborative receivable, which was subsequently collected. During the six months ended June 30, 2011, accounts payable and accrued expenses decreased by an aggregate of \$65,000, compared to an aggregate decrease in accounts payable and accrued expenses of \$1.8 million for the six months ended June 30, 2010. The decreases in accounts payable and accrued expenses during these comparable six month periods were primarily due to payments made for external service costs related to our clinical trials, the timing and amount of which may fluctuate significantly from period to period.

Net cash used in investing activities totaled \$2.3 million for the six months ended June 30, 2011 compared to net cash provided by investing activities of \$3.8 million for the six months ended June 30, 2010. Net cash used in or provided by investing activities has fluctuated significantly from period to period primarily due to the timing of purchases and maturities of investment securities. The increase in net cash used in investing activities for the six months ended June 30, 2011 compared to net cash provided by investing activities for the six months ended June 30, 2010 was primarily due to increased purchases of investment securities, net of maturities of investment securities.

Net cash provided by financing activities totaled \$13.9 million for the six months ended June 30, 2011 compared to net cash used in financing activities of \$207,000 for the six months ended June 30, 2010. The net cash provided by financing activities in the six months ended June 30, 2011 was primarily due to \$13.8 million in net proceeds received from our January 2011 private equity financing.

The following table summarizes our contractual obligations, including interest, at June 30, 2011 (in thousands):

	Total	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
Operating leases	\$ 1,006	\$ 680	\$ 326	\$	\$
Long-term debt	56	43	13		
<b>Total</b>	<b>\$ 1,062</b>	<b>\$ 723</b>	<b>\$ 339</b>	<b>\$</b>	<b>\$</b>

We have also entered into agreements with contract research organizations and other external service providers for services in connection with the development of our product candidates. We were contractually obligated for up to approximately \$9.0 million of future services under these agreements as of June 30, 2011. The nature of the work being conducted under our agreements with contract research organizations is such that, in most cases, the services may be stopped on short notice. In such event, we would not be liable for the full amount of the contract. Our actual contractual obligations will vary depending upon several factors, including the progress and results of the underlying services.

In addition, we have entered into an agreement with the Ipsen Group pursuant to which we licensed certain intellectual property rights that complement our patent portfolio. If certain conditions are met, we would be required to make future payments, including milestones, sublicensing fees and royalties. The amount of potential future milestone payments is \$10.5 million in the aggregate, which amount would be offset by any sublicensing fees we may pay under the agreement. Because these milestone payments would only be payable upon the achievement of specified regulatory events and it is uncertain when, or if, such events will occur, we cannot forecast with any degree of certainty when, or if, we will be required to make payments under the agreement. Accordingly, none of these amounts are included in the above table.

*Off-Balance Sheet Arrangements*

To date, we have not had any relationships with unconsolidated entities or financial partnerships, such as entities referred to as structured finance or special purpose entities, which are established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As such, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in these relationships.

**Recent Accounting Pronouncements**

See Item 1 of Part I, Notes to Condensed Consolidated Financial Statements Note 10 Recent Accounting Pronouncements.



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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

***Interest Rate Risk***

We invest our excess cash in investment-grade, interest-bearing securities. The primary objective of our investment activities is to preserve principal and liquidity. To achieve this objective, we invest in a money market fund, U.S. Treasury notes, and high quality marketable debt instruments of corporations, financial institutions and government sponsored enterprises with contractual maturity dates of generally less than two years. All investment securities have a credit rating of at least AA or A1+/p1 as determined by Moody's Investors Service and/or Standard & Poor's. We do not have any direct investments in auction-rate securities or securities that are collateralized by assets that include mortgages or subprime debt. If a 10 percent change in interest rates were to have occurred on June 30, 2011, this change would not have had a material effect on the fair value of our investment portfolio as of that date.

***Foreign Currency Risk***

We have wholly owned subsidiaries in Europe, which expose us to foreign exchange risk. All assets and liabilities of our subsidiaries are translated to U.S. dollars based on the applicable exchange rate on the balance sheet date. Expense components are translated to U.S. dollars at weighted average exchange rates in effect during the period. Gains and losses resulting from foreign currency translation are included as a component of our stockholders' equity. Other foreign currency transaction gains and losses are included in our results of operations and, to date, have not been significant. We have not hedged exposures denominated in foreign currencies or any other derivative financial instrument.

**ITEM 4. CONTROLS AND PROCEDURES**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our periodic and current reports that we file with the SEC is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable and not absolute assurance of achieving the desired control objectives. In reaching a reasonable level of assurance, management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. In addition, the design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, control may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

As of June 30, 2011, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of June 30, 2011.

**PART II. OTHER INFORMATION**

**ITEM 1A. RISK FACTORS**

*You should consider carefully the following information about the risks described below, together with the other information contained in this Quarterly Report and in our other public filings in evaluating our business. The risk factors set forth below that are marked with an asterisk (\*) contain changes to the similarly titled risk factor included in Item 1A to our Annual Report. If any of the following risks actually occurs, our business, financial condition, results of operations and future growth prospects would likely be materially and adversely affected. In these circumstances, the market price of our common stock would likely decline.*

**Risks Related to Our Business**

*We expect our net losses to continue for at least several years and are unable to predict the extent of future losses or when we will become profitable, if ever.\**

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We have experienced significant net losses since our inception. As of June 30, 2011, we had an accumulated deficit of approximately \$336.5 million. While we did report net income in 2010 due to recognition of revenue following the conclusion of our collaboration with Biovail Laboratories International SRL, a subsidiary of Valeant Pharmaceuticals International (formerly Biovail Corporation), we incurred a net loss for the three and six months ended June 30, 2011 and expect to continue to incur net losses over the next several years as we advance our programs and incur significant clinical development costs.

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We have not received, and do not expect to receive for at least the next several years, any revenues from the commercialization of our product candidates. Substantially all of our revenues for the three and six months ended June 30, 2011 were from our collaborations with Allergan and Meiji Seika Pharma as well as our agreements with other parties. We anticipate that collaborations, which provide us with research funding and potential milestone payments and royalties, will continue to be our primary source of revenues for the next several years.

We cannot be certain that the milestones required to trigger payments under our existing collaborations will be reached or that we will secure additional collaboration agreements. To obtain revenues from our product candidates, we must succeed, either alone or with others, in developing, obtaining regulatory approval for, and manufacturing and marketing drugs with significant market potential. We may never succeed in these activities, and may never generate revenues that are significant enough to achieve profitability.

***We depend on collaborations with third parties to develop and commercialize selected product candidates and to provide substantially all of our revenues.\****

A key aspect of our strategy is to selectively enter into collaboration agreements with third parties. We currently rely, and will continue to rely, on our collaborators for financial resources and for development, regulatory, and commercialization expertise for selected product candidates. The ongoing research term of our agreements with Allergan will end in March 2012, unless extended, and additional payments from our agreements with Allergan and Meiji Seika Pharma are dependent on successful advancement of our applicable product candidates. There is no guarantee that revenues from our ongoing collaborations will continue at current or past levels. Given the current economic environment, it is possible that our existing collaborators may elect to reduce their external spending.

Our collaborators may fail to develop or effectively commercialize products using our product candidates or technologies because they:

do not have sufficient resources or decide not to devote the necessary resources due to internal constraints such as limited cash or human resources or a change in strategic focus;

decide to pursue a competitive product developed outside of the collaboration; or

cannot obtain the necessary regulatory approvals.

For example, Allergan has announced that it is seeking a partner for further development and commercialization of drug candidates in our chronic pain program. If Allergan is unable to successfully partner this program, it may elect to not pursue further development. In addition, any partner that Allergan does identify may devote substantially less resources than Allergan has devoted to our chronic pain program to date.

Each of Meiji Seika Pharma and Allergan can terminate our existing collaborations under specific circumstances, including in some cases the right to terminate without cause upon prior notice. We may not be able to renew our existing collaborations on acceptable terms, if at all. We also face competition in our search for new collaborators, if we seek a new partner for our pimavanserin program. Given the current economic environment, it is possible that competition for new collaborators may increase. If we are unable to renew any existing collaboration or find new collaborations, we may not be able to continue advancing our programs alone.

***If we fail to obtain the capital necessary to fund our operations, we will be unable to successfully develop products.\****

We have consumed substantial amounts of capital since our inception. Our cash and investment securities totaled approximately \$40.4 million at June 30, 2011. While we believe that our existing cash resources and anticipated payments from our collaborations will be sufficient to fund our cash requirements at least into the first half of 2013, we will require significant additional financing in the future to continue to fund our operations. Our future capital requirements will depend on, and could increase significantly as a result of, many factors including:

progress in, and the costs of, our preclinical studies and clinical trials and other research and development programs;

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the scope, prioritization and number of our research and development programs;

the ability of our collaborators and us to reach the milestones, and other events or developments, triggering payments under our collaboration agreements or to otherwise make payments under these agreements;

the extent to which we are obligated to reimburse our collaborators or our collaborators are obligated to reimburse us for clinical trial costs under our collaboration agreements;

the costs involved in filing, prosecuting, enforcing and defending patent claims and other intellectual property rights;

the costs of securing manufacturing arrangements for clinical or commercial production;

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the costs of establishing or contracting for sales and marketing capabilities if we obtain regulatory clearances to market our product candidates; and

the costs associated with litigation.

Until we can generate significant continuing revenues, we expect to satisfy our future cash needs through our existing cash, cash equivalents and investment securities, strategic collaborations, private or public sales of our securities, debt financings, grant funding, or by licensing all or a portion of our product candidates or technology. Turmoil and volatility in the financial markets have adversely affected the market capitalizations of many biotechnology companies, and generally made equity and debt financing more difficult to obtain. This, coupled with other factors, may limit our access to additional financing over the near-term future. This could have a material adverse effect on our ability to access sufficient funding. We cannot be certain that additional funding will be available to us on acceptable terms, if at all. If funds are not available, we may be required to delay, reduce the scope of, or eliminate one or more of our research or development programs or our commercialization efforts. Additional funding, if obtained, may significantly dilute existing stockholders.

***We do not have a partner for the development of our lead product candidate, pimavanserin, and are solely responsible for the advancement of this program.\****

Following the September 2010 merger of Biovail Corporation with Valeant, we entered into an agreement with Biovail in October 2010 to end our collaboration regarding North American rights to pimavanserin. This agreement allowed us to regain the rights that we had licensed to Biovail and receive a one-time payment of \$8.75 million. Pursuant to the collaboration, Biovail had been responsible for funding development of pimavanserin, and seeking regulatory approval for and any future marketing of pimavanserin in North America. Following the end of the collaboration, we now have full responsibility for the pimavanserin program. We expect our research and development costs for the continued development of pimavanserin to continue to be substantial. While we are continuing to run the ongoing trials for pimavanserin, we would need to add resources and raise additional funds in the future in order to take this product candidate to market, if we do not secure another partner.

***Our most advanced product candidates are in clinical trials, which are long, expensive and unpredictable, and there is a high risk of failure.\****

Preclinical testing and clinical trials are long, expensive and unpredictable processes that can be subject to delays. It may take several years to complete the preclinical testing and clinical development necessary to commercialize a drug, and delays or failure can occur at any stage. Interim results of clinical trials do not necessarily predict final results, and success in preclinical testing and early clinical trials does not ensure that later clinical trials will be successful. A number of companies in the pharmaceutical and biotechnology industries have suffered significant setbacks in advanced clinical trials even after promising results in earlier trials.

Our drug development programs are at various stages of development and the historical rate of failures for product candidates is extremely high. In fact, we previously had an unsuccessful Phase III trial with our product candidate, pimavanserin. We are currently conducting the -020 Study, a new Phase III trial with pimavanserin for the treatment of Parkinson's disease psychosis that we initiated in July 2010. An unfavorable outcome in the -020 study would be a major set-back for the program and for us, generally. In particular, an unfavorable outcome in this or other studies in our pimavanserin program may require us to delay, reduce the scope of, or eliminate this program and could have a material adverse effect on us and the value of our common stock. In addition to our pimavanserin program, we also have clinical programs in collaboration with Allergan for the treatment of chronic pain and glaucoma, which are in Phase II and Phase I development, respectively.

In connection with clinical trials, we face risks that:

a product candidate may not prove to be efficacious;

patients may die or suffer other adverse effects for reasons that may or may not be related to the product candidate being tested;

the results may not confirm the positive results of earlier trials; and



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the results may not meet the level of statistical significance required by the U.S. Food and Drug Administration, or FDA, or other regulatory agencies.

If we do not successfully complete preclinical and clinical development, we will be unable to market and sell products derived from our product candidates and to generate product revenues. Even if we do successfully complete clinical trials, those results are not necessarily predictive of results of additional trials that may be needed before a new drug application, or NDA, may be submitted to the FDA. Of the large number of drugs in development, only a small percentage result in the submission of an NDA to the FDA and even fewer are approved for commercialization.

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*Delays, suspensions and terminations in our clinical trials could result in increased costs to us and delay our ability to generate product revenues.*

The commencement of clinical trials can be delayed for a variety of reasons, including delays in:

demonstrating sufficient safety and efficacy to obtain regulatory approval to commence a clinical trial;

reaching agreement on acceptable terms with prospective contract research organizations and clinical trial sites;

manufacturing sufficient quantities of a product candidate;

obtaining approval of an Investigational New Drug Application, or IND, from the FDA;

obtaining institutional review board approval to conduct a clinical trial at a prospective clinical trial site; and

patient enrollment, which is a function of many factors, including the size of the patient population, the nature of the protocol, the proximity of patients to clinical trial sites, the availability of effective treatments for the relevant disease and the eligibility criteria for the clinical trial.

Once a clinical trial has begun, it may be delayed, suspended or terminated due to a number of factors, including:

ongoing discussions with regulatory authorities regarding the scope or design of our clinical trials or requests by them for supplemental information with respect to our clinical trial results;

failure to conduct clinical trials in accordance with regulatory requirements;

lower than anticipated screening or retention rates of patients in clinical trials;

serious adverse events or side effects experienced by participants; and

insufficient supply or deficient quality of product candidates or other materials necessary for the conduct of our clinical trials.

Many of these factors may also ultimately lead to denial of regulatory approval of a current or potential product candidate. If we experience delays, suspensions or terminations in a clinical trial, the commercial prospects for the related product candidate will be harmed, and our ability to generate product revenues will be delayed.

*If conflicts arise with our collaborators, they may act in their self interests, which may be adverse to our interests.\**

Conflicts may arise in our collaborations due to one or more of the following:

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disputes or breaches with respect to payments that we believe are due under the applicable agreements, particularly in the current economic environment when companies, including large established ones, may be seeking to reduce external payments;

disputes on strategy as to what development or commercialization activities should be pursued under the applicable agreements;

disputes as to the responsibility for conducting development and commercialization activities pursuant to the applicable collaboration, including the payment of costs related thereto;

disagreements with respect to ownership of intellectual property rights;

unwillingness on the part of a collaborator to keep us informed regarding the progress of its development and commercialization activities, or to permit public disclosure of these activities;

delay of a collaborator's development or commercialization efforts with respect to our product candidates; or

termination or non-renewal of the collaboration.

Conflicts arising with our collaborators could impair the progress of our product candidates, harm our reputation, result in a loss of revenues, reduce our cash position, and cause a decline in our stock price.

In addition, in our collaborations, we generally have agreed not to conduct independently, or with any third party, any research that is directly competitive with the research conducted under the applicable program. Our collaborations may have the effect of limiting the areas of research that we may pursue, either alone or with others. Our collaborators, however, may develop, either alone or with others, products in related fields that are competitive with the products or potential products that are the subject of these collaborations. Competing products, either developed by our collaborators or to which our collaborators have rights, may result in the allocation of resources by our competitors to competing products and their withdrawal of support for our product candidates or may otherwise result in lower demand for our potential products.

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We have collaborations with Allergan for the development of product candidates related to chronic pain and ophthalmic diseases, including glaucoma. Allergan currently markets therapeutic products to treat glaucoma and is engaged in other research programs related to glaucoma and other ophthalmic products that are independent from our development program in this therapeutic area. Allergan is also pursuing other research programs related to pain management that are independent from our collaboration in this therapeutic area.

Our collaboration with Meiji Seika Pharma is initially focused on the advancement of pro-cognitive drugs, or PCAPs, as a treatment for schizophrenia and related disorders. While Meiji Seika Pharma has rights to the PCAPs in the Asian territory, we have the right to pursue them, alone or with a partner, in the rest of the world. Meiji Seika Pharma is also pursuing other research programs related to schizophrenia that are independent from our collaboration in this therapeutic area.

***We rely on third parties to conduct our clinical trials and perform data collection and analysis, which may result in costs and delays that prevent us from successfully commercializing product candidates.***

Although we design and manage our current preclinical studies and clinical trials, we currently do not have the ability to conduct clinical trials for our product candidates on our own. In addition to our collaborators, we rely on contract research organizations, medical institutions, clinical investigators, and contract laboratories to perform data collection and analysis and other aspects of our clinical trials. In addition, we also rely on third parties to assist with our preclinical studies, including studies regarding biological activity, safety, absorption, metabolism, and excretion of product candidates.

Our preclinical activities or clinical trials may be delayed, suspended, or terminated if:

these third parties do not successfully carry out their contractual duties or fail to meet regulatory obligations or expected deadlines;

these third parties need to be replaced; or

the quality or accuracy of the data obtained by these third parties is compromised due to their failure to adhere to our clinical protocols or regulatory requirements or for other reasons.

Failure to perform by these third parties may increase our development costs, delay our ability to obtain regulatory approval, and delay or prevent the commercialization of our product candidates. We currently use several contract research organizations to perform services for our preclinical studies and clinical trials. While we believe that there are numerous alternative sources to provide these services, in the event that we seek such alternative sources, we may not be able to enter into replacement arrangements without delays or additional expenditures.

***Even if we or our collaborators successfully complete the clinical trials of product candidates, the product candidates may fail for other reasons.***

Even if we or our collaborators successfully complete the clinical trials of product candidates, the product candidates may fail for other reasons, including the possibility that the product candidates will:

fail to receive the regulatory clearances required to market them as drugs;

be subject to proprietary rights held by others requiring the negotiation of a license agreement prior to marketing;

be difficult or expensive to manufacture on a commercial scale;

have adverse side effects that make their use less desirable; or

fail to compete with product candidates or other treatments commercialized by competitors.

***Our product candidates may not gain acceptance among physicians, patients, and the medical community, thereby limiting our potential to generate revenues.***

Even if our product candidates are approved for commercial sale by the FDA or other regulatory authorities, the degree of market acceptance of any approved product candidate by physicians, healthcare professionals and third-party payors, and our profitability and growth will depend on a number of factors, including:

the ability to provide acceptable evidence of safety and efficacy;

relative convenience and ease of administration;

the prevalence and severity of any adverse side effects;

availability of alternative treatments;

pricing and cost effectiveness, which may be subject to regulatory control;

effectiveness of our or our collaborators' sales and marketing strategy; and

our ability to obtain sufficient third-party insurance coverage or reimbursement.

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If any product candidate that we discover and/or develop does not provide a treatment regimen that is as beneficial as the current standard of care or otherwise does not provide patient benefit, that product will not achieve market acceptance and we will not generate sufficient revenues to achieve or maintain profitability.

***If we are unable to attract, retain, and motivate key management and scientific staff, our drug development programs and our research and discovery efforts may be delayed and we may be unable to successfully develop or commercialize our product candidates.***

Our success depends on our ability to attract, retain, and motivate highly qualified management and scientific personnel. In particular, our development programs depend on our ability to attract and retain highly skilled development personnel, especially in the fields of central nervous system disorders, including neuropsychiatric and related disorders. In the future, we may need to hire additional personnel if we expand our research and development efforts from our current levels. We face competition for experienced scientists, clinical operations personnel, and other technical personnel from numerous companies and academic and other research institutions. Competition for qualified personnel is particularly intense in the San Diego, California area. If we are unable to attract and retain the necessary personnel, this will significantly impede the achievement of our research and development objectives and our ability to meet the demands of our collaborators in a timely fashion.

All of our employees are at will employees, which means that any employee may quit at any time and we may terminate any employee at any time. We do not carry key person insurance covering members of senior management.

***We do not know whether our drug discovery platform will lead to the discovery or development of commercially viable product candidates.***

Our drug discovery platform uses new and unproven methods to identify and develop product candidates. We have never successfully completed clinical development of any of our product candidates, and there are no drugs on the market that have been discovered using our drug discovery platform.

Our research and development focuses on small molecule drugs for the treatment of central nervous system disorders. Due to our limited resources, we may have to forego potential opportunities with respect to discovering product candidates to treat diseases or conditions in other therapeutic areas. If we are not able to use our technologies to discover and develop product candidates that can be commercialized, we may not achieve profitability. In the future, we may find it necessary to license the technology of others or acquire additional product candidates to augment the results of our internal discovery activities. If we are unable to identify new product candidates using our drug discovery platform, we may be unable to establish or maintain a clinical development pipeline or generate product revenues.

***We may not be able to continue or fully exploit our collaborations with outside scientific and clinical advisors, which could impair the progress of our clinical trials and our research and development efforts.***

We work with scientific and clinical advisors at academic and other institutions who are experts in the field of central nervous system disorders. They assist us in our research and development efforts and advise us with respect to our clinical trials. These advisors are not employees and may have other commitments that would limit their future availability to us. Although our scientific and clinical advisors generally agree not to engage in competing work, if a conflict of interest arises between their work for us and their work for another entity, we may lose their services, which may impair our reputation in the industry and delay the development or commercialization of our product candidates.

***We will need to continue to manage our organization and we may encounter difficulties with our reduced staffing and any future transitions, which could adversely affect our results of operations.***

We will need to effectively manage our operations and facilities in order to advance our drug development programs, including those covered by our collaborations with Allergan and Meiji Seika Pharma, achieve milestones under our collaboration agreements, facilitate additional collaborations, and pursue other development activities. It is possible that our infrastructure may be inadequate to support our future efforts and growth. In particular, we may have to develop internal sales, marketing, and distribution capabilities if we decide to market any drug that we may successfully develop. We may not successfully manage our operations and, accordingly, may not achieve our research, development, and commercialization goals.

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*We expect that our results of operations will fluctuate, which may make it difficult to predict our future performance from period to period.*

Our quarterly operating results have fluctuated in the past and are likely to do so in the future. Some of the factors that could cause our operating results to fluctuate from period to period include:

the status of development of pimavanserin and our other product candidates, including compounds being developed under our collaborations;

whether we generate revenues or reimbursements by achieving specified research, development or commercialization milestones under any agreements or otherwise receive potential payments under these agreements;

whether we are required to make payments due to achieving specified milestones under any licensing or similar agreements or otherwise make potential payments under these agreements;

the incurrence of preclinical or clinical expenses that could fluctuate significantly from period to period, including reimbursement obligations pursuant to our collaboration agreements;

the initiation, termination, or reduction in the scope of our collaborations or any disputes regarding these collaborations;

the timing of our satisfaction of applicable regulatory requirements;

the rate of expansion of our clinical development and other internal research and development efforts;

the effect of competing technologies and products and market developments;

the costs and benefits associated with our restructuring;

the costs associated with litigation; and

general and industry-specific economic conditions.

We believe that quarterly comparisons of our financial results are not necessarily meaningful and should not be relied upon as indications of our future performance.

***Relying on third-party manufacturers may result in delays in our clinical trials and product introductions.***

We have no manufacturing facilities and have no experience in the manufacturing of drugs or in designing drug-manufacturing processes. We have contracted with third-party manufacturers to produce, in collaboration with us, our product candidates for clinical trials. If any of our product candidates are approved by the FDA or other regulatory agencies for commercial sale, we may need to contract with a third party to manufacture them in larger quantities. We currently use third-party manufacturers to produce clinical supplies of our compounds for us, including pimavanserin. While we believe that there are alternative sources available to manufacture our product candidates, in the event that we seek such alternative sources, we may not be able to enter into replacement arrangements without delays or additional expenditures. We cannot

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estimate these delays or costs with certainty but, if they were to occur, they could cause a delay in our development and commercialization efforts.

The manufacturers of our product candidates are obliged to operate in accordance with FDA-mandated current good manufacturing practices, or cGMPs. A failure of any of our contract manufacturers to establish and follow cGMPs and to document their adherence to such practices may lead to significant delays in clinical trials or in obtaining regulatory approval of product candidates or the ultimate launch of products based on our product candidates into the market. Failure by our third-party manufacturers or us to comply with applicable regulations could result in sanctions being imposed on us, including fines, injunctions, civil penalties, failure of the government to grant pre-market approval of drugs, delays, suspension or withdrawal of approvals, seizures or recalls of products, operating restrictions, and criminal prosecutions.

***Our management has broad discretion over the use of our cash and we may not use our cash effectively, which could adversely affect our results of operations.***

Our management has significant flexibility in applying our cash resources and could use these resources for corporate purposes that do not increase our market value, or in ways with which our stockholders may not agree. We may use our cash resources for corporate purposes that do not yield a significant return or any return at all for our stockholders, which may cause our stock price to decline.

***We have incurred, and expect to continue to incur, significant costs as a result of laws and regulations relating to corporate governance and other matters.***

Laws and regulations affecting public companies, including provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act that was enacted in July 2010, the provisions of the Sarbanes-Oxley Act of 2002, or SOX, and rules adopted or proposed by the SEC and by The Nasdaq Global Market, have resulted in, and will continue to result in, significant costs to us as we evaluate the implications of these rules and respond to their requirements. We issued an evaluation of our internal control over



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financial reporting under Section 404 of SOX with our Annual Report. In the future, if we are not able to issue an evaluation of our internal control over financial reporting as required or we or our independent registered public accounting firm determine that our internal control over financial reporting is not effective, this shortcoming could have an adverse effect on our business and financial results and the price of our common stock could be negatively affected. New rules could make it more difficult or more costly for us to obtain certain types of insurance, including director and officer liability insurance, and we may be forced to accept reduced policy limits and coverage or incur substantially higher costs to obtain the coverage that is the same or similar to our current coverage. The impact of these events could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors and board committees, and as our executive officers. We cannot predict or estimate the total amount of the costs we may incur or the timing of such costs to comply with these rules and regulations.

*Healthcare legislation may make it more difficult to receive revenues, if we have products that are approved.\**

In March 2010, the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Affordability Reconciliation Act, or collectively, PPACA, became law in the United States. PPACA substantially changes the way healthcare is financed by both governmental and private insurers and significantly affects the healthcare industry. Among the provisions of PPACA of importance to our potential product candidates are the following:

a new Medicare Part D coverage gap discount program, in which manufacturers must agree to offer 50% point-of-sale discounts off negotiated prices of applicable brand drugs to eligible beneficiaries during their coverage gap period, as a condition for the manufacturer's outpatient drugs to be covered under Medicare Part D;

extension of manufacturers' Medicaid rebate liability to covered drugs dispensed to individuals who are enrolled in Medicaid managed care organizations;

expansion of eligibility criteria for Medicaid programs by, among other things, allowing states to offer Medicaid coverage to additional individuals and, beginning in 2014, by adding new mandatory eligibility categories for certain individuals with income at or below 133% of the Federal Poverty Level, thereby potentially increasing manufacturers' Medicaid rebate liability;

expansion of the entities eligible for discounts under the Public Health Service pharmaceutical pricing program;

new requirements to report certain financial arrangements with physicians, including reporting any transfer of value made or distributed to prescribers and other healthcare providers, effective March 30, 2013, and reporting any investment interests held by physicians and their immediate family members during the preceding calendar year;

a new requirement to annually report drug samples that manufacturers and distributors provide to physicians;

a licensure framework for follow-on biologic products; and

a new Patient-Centered Outcomes Research Institute to oversee, identify priorities in, and conduct comparative clinical effectiveness research, along with funding for such research.

We expect that the PPACA, as well as other healthcare reform measures that may be adopted in the future, may result in more rigorous coverage criteria and in additional downward pressure on the price that we receive for any approved product, and could seriously harm our business. Any reduction in reimbursement from Medicare or other government programs may result in a similar reduction in payments from private payors.

*If we are unable to establish sales and marketing capabilities or enter into agreements with third parties to sell and market any products we may develop, we may not be able to generate product revenue.*

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We do not currently have an organization for the sales, marketing and distribution of pharmaceutical products. In order to market any products that may be approved by the FDA, we must build our sales, marketing, managerial, and related capabilities or make arrangements with third parties to perform these services. If we are unable to establish adequate sales, marketing, and distribution capabilities, whether independently or with third parties, we may not be able to generate product revenue and may not become profitable.

***If we engage in any acquisition, we will incur a variety of costs and may never realize the anticipated benefits of the acquisition.***

We may attempt to acquire businesses, technologies, services, or products or license in technologies that we believe are a strategic fit with our business. We have limited experience in identifying acquisition targets, successfully completing proposed acquisitions and integrating any acquired businesses, technologies, services or products into our current infrastructure. The process of integrating any acquired business, technology, service, or product may result in unforeseen operating difficulties and expenditures and may divert significant management attention from our ongoing business operations. As a result, we will incur a variety of costs in connection with an acquisition and may never realize its anticipated benefits.

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*Earthquake or fire damage to our facilities could delay our research and development efforts and adversely affect our business.*

Our headquarters and research and development facilities in San Diego are located in a seismic zone, and there is the possibility of an earthquake, which could be disruptive to our operations and result in delays in our research and development efforts. In addition, while our facilities have not been adversely impacted by local wildfires, there is the possibility of future fires in the area. In the event of an earthquake or fire, if our facilities or the equipment in our facilities is significantly damaged or destroyed for any reason, we may not be able to rebuild or relocate our facilities or replace any damaged equipment in a timely manner and our business, financial condition, and results of operations could be materially and adversely affected. We do not have insurance for damages resulting from earthquakes. While we do have fire insurance for our property and equipment located in San Diego, any damage sustained in a fire could cause a delay in our research and development efforts and our results of operations could be materially and adversely affected.

## **Risks Related to Our Intellectual Property**

*Our ability to compete may decline if we do not adequately protect our proprietary rights.*

Our commercial success depends on obtaining and maintaining proprietary rights to our product candidates and technologies and their uses, as well as successfully defending these rights against third-party challenges. We will only be able to protect our product candidates, proprietary technologies, and their uses from unauthorized use by third parties to the extent that valid and enforceable patents, or effectively protected trade secrets, cover them. Although we have filed numerous patent applications worldwide with respect to pimavanserin, we have been issued only a limited number of patents with respect to these filings.

Our ability to obtain patent protection for our product candidates and technologies is uncertain due to a number of factors, including:

we may not have been the first to make the inventions covered by our pending patent applications or issued patents;

we may not have been the first to file patent applications for our product candidates or the technologies we rely upon;

others may independently develop similar or alternative technologies or duplicate any of our technologies;

our disclosures in patent applications may not be sufficient to meet the statutory requirements for patentability;

any or all of our pending patent applications may not result in issued patents;

we may not seek or obtain patent protection in all countries that will eventually provide a significant business opportunity;

any patents issued to us or our collaborators may not provide a basis for commercially viable products, may not provide us with any competitive advantages or may be challenged by third parties;

our proprietary technologies may not be patentable;

others may design around our patent claims to produce competitive products which fall outside of the scope of our patents;

others may identify prior art which could invalidate our patents; or

changes to patent laws that limit the exclusivity rights of patent holders.

Even if we have or obtain patents covering our product candidates or technologies, we may still be barred from making, using and selling our product candidates or technologies because of the patent rights of others. Others have or may have filed, and in the future are likely to file, patent applications covering compounds, assays, genes, gene products or therapeutic products that are similar or identical to ours. There are many issued U.S. and foreign patents relating to genes, nucleic acids, polypeptides, chemical compounds or therapeutic products, and some of these may encompass reagents utilized in the identification of candidate drug compounds or compounds that we desire to commercialize. Numerous U.S. and foreign issued patents and pending patent applications owned by others exist in the area of central nervous system disorders and the other fields in which we are developing products. These could materially affect our ability to develop our product candidates or sell our products. Because patent applications can take many years to issue, there may be currently pending applications, unknown to us, that may later result in issued patents that our product candidates or technologies may infringe. These patent applications may have priority over patent applications filed by us.

We regularly conduct searches to identify patents or patent applications that may prevent us from obtaining patent protection for our proprietary compounds or that could limit the rights we have claimed in our patents and patent applications. Disputes may arise regarding the ownership or inventorship of our inventions. It is difficult to determine how such disputes would be resolved. Others may challenge the validity of our patents. If our patents are found to be invalid, we will lose the ability to exclude others from making, using or selling the inventions claimed therein.

Some of our academic institutional licensors, research collaborators and scientific advisors have rights to publish data and information to which we have rights. If we cannot maintain the confidentiality of our technology and other confidential information in connection with our collaborations, then our ability to receive patent protection or protect our proprietary information will be impaired. Additionally, employees whose positions were eliminated in connection with restructurings may seek future employment with our competitors. Although each of our employees is required to sign a confidentiality agreement with us at the time of hire, we

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cannot guarantee that the confidential nature of our proprietary information will be maintained in the course of such future employment. In addition, technology that we may license in may become important to some aspects of our business. We generally will not control the patent prosecution, maintenance or enforcement of in-licensed technology.

***Confidentiality agreements with employees and others may not adequately prevent disclosure of our trade secrets and other proprietary information and may not adequately protect our intellectual property, which could limit our ability to compete.***

Because we operate in the highly technical field of drug discovery and development of small molecule drugs, we rely in part on trade secret protection in order to protect our proprietary technology and processes. However, trade secrets are difficult to protect. We enter into confidentiality and intellectual property assignment agreements with our corporate partners, employees, consultants, outside scientific collaborators, sponsored researchers, and other advisors. These agreements generally require that the other party keep confidential and not disclose to third parties all confidential information developed by the party or made known to the party by us during the course of the party's relationship with us. These agreements also generally provide that inventions conceived by the party in the course of rendering services to us will be our exclusive property. However, these agreements may not be honored and may not effectively assign intellectual property rights to us. Enforcing a claim that a party illegally obtained and is using our trade secrets is difficult, expensive and time consuming and the outcome is unpredictable. In addition, courts outside the United States may be less willing to protect trade secrets. The failure to obtain or maintain trade secret protection could adversely affect our competitive position. In addition, we have not entered into any noncompete agreements with any of our employees.

***A dispute concerning the infringement or misappropriation of our proprietary rights or the proprietary rights of others could be time consuming and costly, and an unfavorable outcome could harm our business.***

There is significant litigation in our industry regarding patent and other intellectual property rights. While we are not currently subject to any pending intellectual property litigation, and are not aware of any such threatened litigation, we may be exposed to future litigation by third parties based on claims that our product candidates, technologies or activities infringe the intellectual property rights of others. In particular, there are many patents relating to specific genes, nucleic acids, polypeptides or the uses thereof to identify product candidates. Some of these may encompass genes or polypeptides that we utilize in our drug development activities. If our drug development activities are found to infringe any such patents, we may have to pay significant damages or seek licenses to such patents. A patentee could prevent us from using the patented genes or polypeptides for the identification or development of drug compounds. There are also many patents relating to chemical compounds and the uses thereof. If our compounds are found to infringe any such patents, we may have to pay significant damages or seek licenses to such patents. A patentee could prevent us from making, using or selling the patented compounds. We may need to resort to litigation to enforce a patent issued to us, protect our trade secrets or determine the scope and validity of third-party proprietary rights. From time to time, we may hire scientific personnel formerly employed by other companies involved in one or more areas similar to the activities conducted by us. Either we or these individuals may be subject to allegations of trade secret misappropriation or other similar claims as a result of their prior affiliations. If we become involved in litigation, it could consume a substantial portion of our managerial and financial resources, regardless of whether we win or lose. We may not be able to afford the costs of litigation. Any legal action against us or our collaborators could lead to:

payment of damages, potentially treble damages, if we are found to have willfully infringed a party's patent rights;

injunctive or other equitable relief that may effectively block our ability to further develop, commercialize, and sell products; or

we or our collaborators having to enter into license arrangements that may not be available on commercially acceptable terms, if at all.

As a result, we could be prevented from commercializing current or future products.

***The patent applications of pharmaceutical and biotechnology companies involve highly complex legal and factual questions, which, if determined adversely to us, could negatively impact our patent position.***

The patent positions of pharmaceutical and biotechnology companies can be highly uncertain and involve complex legal and factual questions. For example, some of our patent applications will cover gene sequences and products and the uses of those gene sequences and products. Public disclosures and patent applications related to the Human Genome Project and other genomics efforts may limit the scope of our claims or make unpatentable subsequent patent applications. No consistent policy regarding the breadth of claims allowed in biotechnology patents has emerged

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to date. The United States Patent and Trademark Office's standards are uncertain and could change in the future. Consequently, the issuance and scope of patents cannot be predicted with certainty. Patents, if issued, may be challenged, invalidated or circumvented. U.S. patents and patent applications may also be subject to interference proceedings, and U.S. patents may be subject to reexamination proceedings in the United States Patent and Trademark Office (and foreign patents may be subject to opposition or comparable proceedings in the corresponding foreign patent office), which proceedings could result in either loss of the patent or denial of the patent application or loss or reduction in the scope of one or more of the claims of the patent or patent application. In addition, such interference, reexamination and opposition proceedings may be costly. Accordingly, rights under any issued patents may not provide us with sufficient protection against competitive products or processes.

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In addition, changes in or different interpretations of patent laws in the United States and foreign countries may permit others to use our discoveries or to develop and commercialize our technology and products without providing any compensation to us or may limit the number of patents or claims we can obtain. In particular, there have been proposals to shorten the exclusivity periods available under U.S. patent law that, if adopted, could substantially harm our business. The product candidates that we are developing are protected by intellectual property rights, including patents and patent applications. If any of our product candidates becomes a marketable product, we will rely on our exclusivity under patents to sell the compound and recoup our investments in the research and development of the compound. If the exclusivity period for patents is shortened, then our ability to generate revenues without competition will be reduced and our business could be materially adversely impacted. The laws of some countries do not protect intellectual property rights to the same extent as U.S. laws and those countries may lack adequate rules and procedures for defending our intellectual property rights. For example, some countries, including many in Europe, do not grant patent claims directed to methods of treating humans and, in these countries, patent protection may not be available at all to protect our product candidates. In addition, U.S. patent laws may change which could prevent or limit us from filing patent applications or patent claims to protect our products and/or technologies or limit the exclusivity periods that are available to patent holders.

If we fail to obtain and maintain patent protection and trade secret protection of our product candidates, proprietary technologies and their uses, we could lose our competitive advantage and competition we face would increase, reducing our potential revenues and adversely affecting our ability to attain or maintain profitability.

### **Risks Related to Our Industry**

*We will be subject to stringent regulation in connection with the marketing of any products derived from our product candidates, which could delay the development and commercialization of our products.*

The pharmaceutical industry is subject to stringent regulation by the FDA and other regulatory agencies in the United States and by comparable authorities in other countries. Neither we nor our collaborators can market a pharmaceutical product in the United States until it has completed rigorous preclinical testing and clinical trials and an extensive regulatory clearance process implemented by the FDA. Satisfaction of regulatory requirements typically takes many years, depends upon the type, complexity and novelty of the product, and requires substantial resources. Even if regulatory approval is obtained, it may impose significant restrictions on the indicated uses, conditions for use, labeling, advertising, promotion, and/or marketing of such products, and requirements for post-approval studies, including additional research and development and clinical trials. These limitations may limit the size of the market for the product or result in the incurrence of additional costs. Any delay or failure in obtaining required approvals could have a material adverse effect on our ability to generate revenues from the particular product candidate.

Outside the United States, the ability to market a product is contingent upon receiving approval from the appropriate regulatory authorities. The requirements governing the conduct of clinical trials, marketing authorization, pricing, and reimbursement vary widely from country to country. Only after the appropriate regulatory authority is satisfied that adequate evidence of safety, quality, and efficacy has been presented will it grant a marketing authorization. Approval by the FDA does not automatically lead to the approval by regulatory authorities outside the United States and, similarly, approval by regulatory authorities outside the United States will not automatically lead to FDA approval.

In addition, U.S. and foreign government regulations control access to and use of some human or other tissue samples in our research and development efforts. U.S. and foreign government agencies may also impose restrictions on the use of data derived from human or other tissue samples. Accordingly, if we fail to comply with these regulations and restrictions, the commercialization of our product candidates may be delayed or suspended, which may delay or impede our ability to generate product revenues.

*If our competitors develop and market products that are more effective than our product candidates, they may reduce or eliminate our commercial opportunity.*

Competition in the pharmaceutical and biotechnology industries is intense and expected to increase. We face competition from pharmaceutical and biotechnology companies, as well as numerous academic and research institutions and governmental agencies, both in the United States and abroad. Some of these competitors have products or are pursuing the development of drugs that target the same diseases and conditions that are the focus of our drug development programs.

For example, our potential product for Parkinson's disease psychosis would compete with off-label use of antipsychotic drugs, including Seroquel, marketed by Astra-Zeneca, and with the generic drug clozapine. Our potential products for the treatment of schizophrenia would compete with Zyprexa, marketed by Eli Lilly, Fanapt marketed by Novartis Pharmaceuticals, Risperdal, marketed by Johnson & Johnson, Abilify, marketed jointly by Bristol-Myers Squibb and Otsuka Pharmaceutical, Seroquel, and clozapine. Our potential product for Alzheimer's disease psychosis would compete with off-label use of antipsychotic drugs. In the area of chronic pain, potential products would compete with

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Neurontin and Lyrica, marketed by Pfizer, and Cymbalta, marketed by Eli Lilly, as well as a variety of generic or proprietary opioids. Our potential products for the treatment of glaucoma would compete with Xalatan, marketed by Pfizer, and Lumigan and Alphagan, marketed by Allergan.



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Many of our competitors and their collaborators have significantly greater experience than we do in the following:

identifying and validating targets;

screening compounds against targets;

preclinical studies and clinical trials of potential pharmaceutical products; and

obtaining FDA and other regulatory approvals.

In addition, many of our competitors and their collaborators have substantially greater capital and research and development resources, manufacturing, sales and marketing capabilities, and production facilities. Smaller companies also may prove to be significant competitors, particularly through proprietary research discoveries and collaboration arrangements with large pharmaceutical and established biotechnology companies. Many of our competitors have products that have been approved or are in advanced development and may develop superior technologies or methods to identify and validate drug targets and to discover novel small molecule drugs. Our competitors, either alone or with their collaborators, may succeed in developing drugs that are more effective, safer, more affordable, or more easily administered than ours and may achieve patent protection or commercialize drugs sooner than us. Our competitors may also develop alternative therapies that could further limit the market for any drugs that we may develop. Our failure to compete effectively could have a material adverse affect on our business.

***Any claims relating to improper handling, storage, or disposal of biological, hazardous, and radioactive materials used in our business could be costly and delay our research and development efforts.***

Our research and development activities involve the controlled use of potentially harmful hazardous materials, including volatile solvents, biological materials such as blood from patients that has the potential to transmit disease, chemicals that cause cancer, and various radioactive compounds. Our operations also produce hazardous waste products. We face the risk of contamination or injury from the use, storage, handling or disposal of these materials. We are subject to federal, state and local laws and regulations governing the use, storage, handling, and disposal of these materials and specified waste products. The cost of compliance with these laws and regulations could be significant, and current or future environmental regulations may impair our research, development, or production efforts. If one of our employees were accidentally injured from the use, storage, handling, or disposal of these materials, the medical costs related to his or her treatment would be covered by our workers compensation insurance policy. However, we do not carry specific biological or hazardous waste insurance coverage and our general liability insurance policy specifically excludes coverage for damages and fines arising from biological or hazardous waste exposure or contamination. Accordingly, in the event of contamination or injury, we could be subject to criminal sanctions or fines or be held liable for damages, our operating licenses could be revoked, or we could be required to suspend or modify our operations and our research and development efforts.

***Consumers may sue us for product liability, which could result in substantial liabilities that exceed our available resources and damage our reputation.***

Researching, developing, and commercializing drug products entails significant product liability risks. Liability claims may arise from our and our collaborators' use of products in clinical trials and the commercial sale of those products. Consumers may make these claims directly and our collaborators or others selling these products may seek contribution from us if they receive claims from consumers. Although we currently have product liability insurance that covers our clinical trials, we will need to increase and expand this coverage as we commence larger scale trials and if our product candidates are approved for commercial sale. This insurance may be prohibitively expensive or may not fully cover our potential liabilities. Inability to obtain sufficient insurance coverage at an acceptable cost or otherwise to protect against potential product liability claims could prevent or inhibit the commercialization of products that we or our collaborators develop. Product liability claims could have a material adverse effect on our business and results of operations. Our liability could exceed our total assets if we do not prevail in a lawsuit from any injury caused by our drug products.

### **Risks Related to Our Common Stock**

***Our stock price may be particularly volatile because we are a drug discovery and development company.\****

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The market prices for securities of biotechnology companies in general, and drug discovery and development companies in particular, have been highly volatile and may continue to be highly volatile in the future. The following factors, in addition to other risk factors described in this section, may have a significant impact on the market price of our common stock:

the development status of our product candidates, including results of our clinical trials for our pimavanserin program or our chronic pain or glaucoma collaborations;

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the initiation, termination, or reduction in the scope of our collaborations or any disputes or developments regarding our collaborations;

market conditions or trends related to biotechnology and pharmaceutical industries, or the market in general;

announcements of technological innovations, new commercial products, or other material events by our competitors or us;

disputes or other developments concerning our proprietary rights;

changes in, or failure to meet, securities analysts' or investors' expectations of our financial performance;

our failure to meet applicable Nasdaq listing standards and the possible delisting of our common stock from the Nasdaq Global Market;

additions or departures of key personnel;

discussions of our business, products, financial performance, prospects, or stock price by the financial and scientific press and online investor communities such as blogs and chat rooms;

public concern as to, and legislative action with respect to, genetic testing or other research areas of biopharmaceutical companies, the pricing and availability of prescription drugs, or the safety of drugs and drug delivery techniques;

regulatory developments in the United States and in foreign countries;

the announcement of, or developments in, any litigation matters; or

economic and political factors, including but not limited to economic and financial crises, wars, terrorism, and political unrest. In particular, our development program with pimavanserin encompasses a number of studies, including Phase III trials, open-label safety extension trials and a range of supporting studies, including carcinogenicity studies, and drug-drug interaction studies. Another unfavorable outcome in one or more of the studies in the development of pimavanserin could be a major set-back for our company, generally. Such an unfavorable outcome could have a material adverse effect on our company and the value of our common stock.

In the past, following periods of volatility in the market price of a particular company's securities, securities class action litigation has often been brought against that company. We may become subject to this type of litigation, which is often extremely expensive and diverts management's attention.

***If we or our stockholders sell substantial amounts of our common stock, the market price of our common stock may decline.\****

A significant number of shares of our common stock are held by a small number of stockholders. Sales of a significant number of shares of our common stock, or the expectation that such sales may occur, could significantly reduce the market price of our common stock. We have an effective registration statement in connection with a private financing that we concluded in January 2011, which registration covers approximately 17.0 million shares of our common stock. We also have an effective registration statement to sell shares of our common stock on

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our own behalf, and may elect to sell shares pursuant to such registration from time to time, as we did, in April 2011, pursuant to the termination agreement we entered into regarding the lease of a facility in Sweden. Our stock price may decline as a result of the sale of the shares of our common stock included in any of these registration statements.

***If the price of our common stock trades below \$1.00 per share for a sustained period or we do not meet other continued listing requirements, our common stock may be delisted from the Nasdaq Global Market.***

The Nasdaq Global Market imposes, among other requirements, listing maintenance standards as well as minimum bid and public float requirements. In particular, Nasdaq rules require us to maintain a minimum bid price of \$1.00 per share of our common stock and to have a specified level of stockholder equity. If the closing bid price of our common stock is below \$1.00 per share for 30 consecutive trading days, which was the case in 2010, or we do not meet other requirements, which was the case in 2010 when we failed to meet the minimum market value listing requirement, we would fail to be in compliance with Nasdaq's continued listing standards and, if we are unable to cure the non-compliance within 180 days, our common stock may be delisted from the Nasdaq Global Market and we may not be able to maintain the continued listing of our common stock on the Nasdaq Global Market. Delisting could adversely affect the market liquidity of our common stock and the market price of our common stock could decrease. Such delisting could also adversely affect our ability to obtain financing for the continuation of our operations.

***If our officers, directors, and largest stockholders choose to act together, they may be able to significantly influence our management and operations, acting in their best interests and not necessarily those of our other stockholders.***

Our directors, executive officers and holders of five percent or more of our outstanding common stock and their affiliates beneficially own a substantial portion of our outstanding common stock. As a result, these stockholders, acting together, have the ability to significantly influence all matters requiring approval by our stockholders, including the election of all of our board members, amendments to our certificate of incorporation, going-private transactions, and the approval of mergers or other business combination transactions. The interests of this group of stockholders may not always coincide with the company's interests or the interests of other stockholders and they may act in a manner that advances their best interests and not necessarily those of our other stockholders.

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*Anti-takeover provisions in our charter documents and under Delaware law may make an acquisition of us more complicated and may make the removal and replacement of our directors and management more difficult.*

Our amended and restated certificate of incorporation and amended and restated bylaws contain provisions that may delay or prevent a change in control, discourage bids at a premium over the market price of our common stock and adversely affect the market price of our common stock and the voting and other rights of the holders of our common stock. These provisions may also make it difficult for stockholders to remove and replace our board of directors and management. These provisions:

establish that members of the board of directors may be removed only for cause upon the affirmative vote of stockholders owning at least a majority of our capital stock;

authorize the issuance of blank check preferred stock that could be issued by our board of directors to increase the number of outstanding shares and prevent or delay a takeover attempt;

limit who may call a special meeting of stockholders;

establish advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted upon at stockholder meetings;

prohibit our stockholders from making certain changes to our amended and restated certificate of incorporation or amended and restated bylaws except with  $66\frac{2}{3}$  percent stockholder approval; and

provide for a board of directors with staggered terms.

We are also subject to provisions of the Delaware corporation law that, in general, prohibit any business combination with a beneficial owner of 15 percent or more of our common stock for 3 years unless the holder's acquisition of our stock was approved in advance by our board of directors. Although we believe these provisions collectively provide for an opportunity to receive higher bids by requiring potential acquirors to negotiate with our board of directors, they would apply even if the offer may be considered beneficial by some stockholders.

*Adverse securities and credit market conditions may significantly affect our ability to raise capital.\**

Turmoil and volatility in the financial markets have adversely affected the market capitalizations of many biotechnology companies and generally made equity and debt financing more difficult to obtain. This, coupled with other factors, may limit access to financing over the near-term future. This could have a material adverse effect on our ability to access funding on acceptable terms, or at all, and our stock price may suffer further as a result.

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<b>Number</b>	<b>Description</b>
3.1	Amended and Restated Certificate of Incorporation, as amended.
3.2	Amended and Restated Bylaws (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K, filed December 17, 2009).
4.1	Form of common stock certificate of the Registrant (incorporated by reference to Exhibit 4.1 to Registration Statement No. 333-52492).
4.2	Form of Warrant to Purchase Preferred Stock issued to GATX Ventures on May 31, 2002 (incorporated by reference to Exhibit 4.3 to Registration Statement No. 333-113137).
4.3	Form of Warrant to Purchase Common Stock issued to Kingsbridge Capital Limited on August 4, 2008 (incorporated by reference to Exhibit 4.4 to the Registrant's Quarterly Report on Form 10-Q, filed August 7, 2008).
4.4	Form of Warrant to Purchase Common Stock issued to purchasers in a private placement on January 12, 2011 (incorporated by reference to Exhibit 4.5 to Registration Statement No 333-171722).
10.1	Termination Agreement by and between Registrant, Nordsviten AB, Wihlborgs Fastigheter AB and Medeon Fastigheter AB, dated April 8, 2011 (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q, filed May 10, 2011).
31.1	Certification of Uli Hacksell, Ph.D., Chief Executive Officer, pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Thomas H. Aasen, Chief Financial Officer, pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Uli Hacksell, Ph.D., Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Thomas H. Aasen, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following financial statements from Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2011, filed on August 10, 2011, formatted in XBRL: (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Operations, (iii) Condensed Consolidated Statements of Cash Flows, and (iv) the Notes to Condensed Consolidated Financial Statements, tagged as blocks of text.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**ACADIA Pharmaceuticals Inc.**

Date: August 10, 2011

By: /s/ Uli Hacksell, Ph.D.  
Uli Hacksell, Ph.D.  
Chief Executive Officer

(on behalf of the registrant and as the  
registrant's Principal Executive Officer)

By: /s/ Thomas H. Aasen  
Thomas H. Aasen  
Executive Vice President, Chief Financial Officer  
and Chief Business Officer

(on behalf of the registrant and as the  
registrant's Principal Financial and Accounting Officer)